199940043

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Uniform Issue List: 401.00-00

Person to Contact:

Telephone Number:

Refer Reply to:

QP:E:EP:T:3

Date:

Attention:

JUL 16 1999

Legend:

District A =

Bank B =

System C =

Plan X =

Dear

This is in reply to your letter of October 15, 1998, submitted on behalf of the Bank, requesting rulings on the federal income tax consequences of a proposed amendment to the Plan. In brief, under the Plan as amended, the dollar equivalent of leave earned by an employee that would have previously been forfeited by the employee will be contributed to the Plan.

The System is a national system of federally-chartered cooperative lending institutions (including banks and associations) that are chartered under the Farm Credit Act of 1971, as amended, and are instrumentalities of the United States. There are several districts within System C. District A maintains Plan X for employees of the various banks and associations within its geographical territory. Plan X is a governmental plan, and is qualified under section 401(a) of the Internal Revenue Code.

Employees within District A are entitled to a certain number of hours or days of paid leave based on their years of service and/or the grade level of their positions. Annual leave accrues on a monthly or a yearly basis. The various entities within District A each maintain their own annual leave policy. The leave policies are similar and all limit the total amount of leave that an employee can receive. The leave policies differ in how the leave is limited. Some policies apply a "Carry-Over Limit" which limits the number of hours or days of leave that any given employee can "carry over" from year to year. Other leave policies have an "Accrual Cap" that limits the number of hours or days that an employee can accrue during a calendar year.

254

The proposed amendment will provide that employees who are subject to a Carry-Over Limit will receive a contribution to Plan X equal to (1) the excess of the total number of hours/days of paid leave that the employee accrued as of the last day of the year over the applicable Carry-Over Limit, multiplied by (2) the participant's hourly/daily rate of pay as of the date of the contribution. Employees who are subject to an Accrual Cap will receive a contribution to Plan X equal to (1) the excess of the total number of hours of paid leave that the employee would have accrued as of the last day of the year if the applicable Accrual Cap were not in place over the applicable Accrual Cap, multiplied by (2) the participant's rate of pay on the date of the contribution.

You represent that the contributions attributable to leave that an employee would otherwise lose will be treated as employer contributions. You further represent that the employees will not have the option to receive cash in lieu of either the forfeited leave or the Plan X contribution.

Based on the foregoing, your request rulings that the contributions made under the arrangement described above (1) will constitute nonelective employer contributions rather than elective contributions within the meaning of section 1.401(k)-1(a)(3) of the Income Tax Regulations that are not includable in employees' gross wages for purposes of FICA under section 3121 of the Code; and (2) will not result in the constructive receipt of income to the participants within the meaning of section 451 of the Code.

A ruling was also requested concerning section 402(g) of the Code. You were informed by letter, dated December 7, 1998, that we will not rule on your ruling request concerning section 402(g). , pursuant to section 6.03 of Revenue Procedure 98-4, 1998-1 I.R.B. 113, because it involves the qualified status of Plan X.

Section 401(k)(2)(A) of the Code defines a cash or deferred arrangement as any arrangement which is part of a profit sharing plan under which an employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash. Section 1.401-1(a)(3)(i) of the Income Tax Regulations defines a cash or deferred election as any election by an employee to have the employer either (A) provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation.

Section 1.401(k)-1(g)(12) of the Income Tax Regulations defines nonelective contributions as employer contributions (other than matching contributions) with respect to which the employee may not elect to have the contributions paid to the employee in cash or other benefits instead of being contributed to the plan.

Section 1.401(m)-1(f)(10) defines matching contributions as (A) any employer contribution (including a contribution made at the employer's discretion) to a defined contribution plan on account of an employee's contribution to a plan maintained by the employer; (B) any employer contribution (including a contribution made at the employer's discretion) to a defined

contribution plan on account of an elective deferral; and (C) any forfeiture allocated on the basis of employee contributions, matching contributions or elective contributions.

Under the proposed amendment, an employee's only options with respect to her leave are (1) to take the leave time that would otherwise be forfeited, or (2) to receive a Plan contribution based on the amount of leave that would be forfeited under either the Carry-Over Limit or the Accrual Cap restrictions. The employee's cash compensation is not affected by her choice. Because an employee will not have the option to receive additional cash or any other taxable benefit in lieu of the additional Plan X contribution, her choice between the two options discussed above is not a cash or deferred election. Further, the contribution is not a matching contribution, as defined under the Regulations. The contribution is a nonelective employer contribution.

Section 1.451-2(a) of the Regulations states, in part, that income, although not actually reduced to the taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Because the employees who receive Plan X contributions under the proposed amendment to Plan X cannot receive the forfeitable leave in any other form during the year, the employees are not in constructive receipt of the amount of the Plan X contribution.

Under section 3121(a)(5)(A) of the Code, in general, a payment made by an employer on behalf of an employee to a trust described in section 401(a) is not included in the term "wages" for purposes of the Federal Insurance Contributions Act (FICA). However, section 3121(v)(1)(A) provides that an employer contribution under a qualified cash or deferred arrangement under section 401(k) is includable in wages for FICA purposes.

As discussed above, the contribution based on annual leave is a nonelective employer contribution and is not part of a cash or deferred arrangement.

Accordingly, we conclude that the contributions described above (1) will constitute nonelective employer contributions rather than elective contributions within the meaning of section 1.401(k)-1(a)(3)(l) of the Income Tax Regulations that are not includable in employees' gross wages for purposes of FICA under section 3121 of the Code; and (2) will not result in the constructive receipt of income to the participants within the meaning of section 451 of the Code.

This ruling is based on the assumption that Plan X, as amended, is qualified under section 401(a) of the Code.

Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the above transaction under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it and applies only to the Plan as proposed to be amended as of the date of this ruling. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

CC:

257